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TRANSPORTATION ISSUES IN CANADA

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Science and Technology Division

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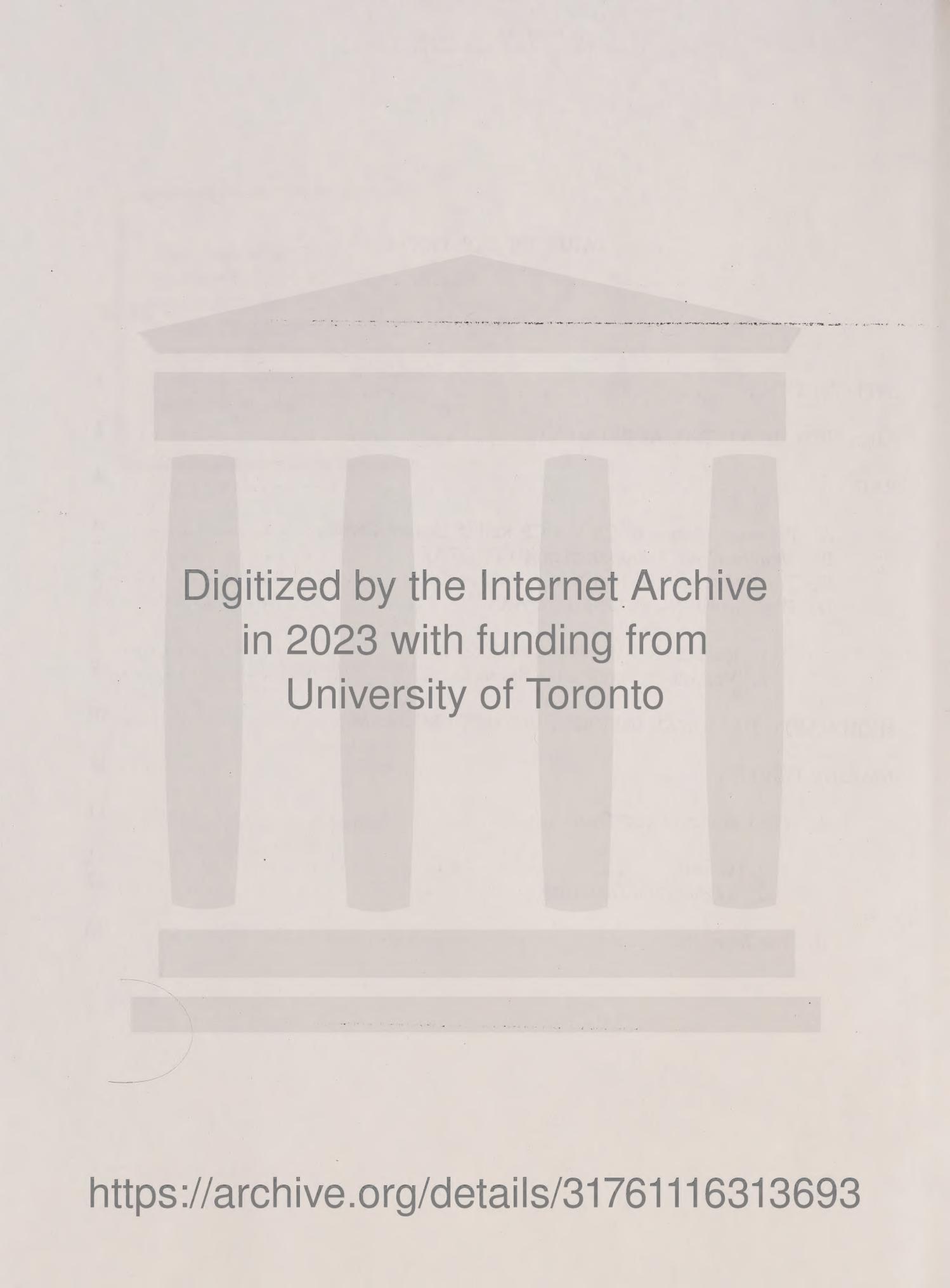
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TRANSPORTATION ISSUES IN CANADA

INTRODUCTION

Since the building of the transcontinental railway in the 1870s, transportation has played a symbolic and tangible role in the development of this nation. From its very beginning, Canada has had to overcome many obstacles, not the least being geography. In establishing this country, Canadians linked communities by rail, road and air networks, over and across some of the world's toughest terrain, at the same time building a port and marine infrastructure to enable their products to reach world markets. Thus, in meeting the challenges of geography and international trade, Canada became a recognized world leader in transportation.

A new transportation and economic environment (NAFTA and GATT) and the changing needs of shippers have, however, dramatically increased the competitive threat to the Canadian transportation industry. While the individual sectors of the industry all enjoy a strong reputation for quality and value, they have, for the most part, pursued their interests independently of one another; the result is a fragmented national transportation system that is less efficient than it could be.

Increasingly, the key sectors of the industry have called for more cooperation and integration to create a coordinated, competitive and reliable system that can collectively promote and enhance overall quality and efficiency.

In addition to the central question of developing a unified policy framework, a number of other issues need to be addressed. These include: open skies, cost recovery, the proposed CN Rail/CP Rail merger in eastern Canada, the future of VIA Rail and the Canadian Coast Guard, the *Western Grain Transportation Act*, high speed rail passenger service, a national highway infrastructure program and the implication of changes to the *Jones Act*.

AIR: NEW BILATERAL AGREEMENTS

Since 1949, Canada-U.S. transborder air services have been governed by a series of bilateral agreements which apply to passenger and cargo services. In response to pressure from both countries for a new agreement that would allow for expanded, more competitive transborder air services, Canada and the United States began negotiating a new bilateral air agreement in April 1991. These negotiations have been termed "open skies" because they are attempting to "open" the skies to more flights between more destinations. A Special Committee of the House of Commons studied this issue in 1990 and identified three negotiating options: liberalization, open skies and open skies with cabotage.

Liberalization would mean the negotiation of a revised, updated air agreement that would be more pro-competitive, flexible and expansive. It would involve the exchange of various routes between city pairs and might well include continued regulation, as well as a formal process by which the two countries would designate carriers to operate on specific routes. Simply put, liberalization would imply the negotiation of a route-specific regime--much the same as we have now.

Under an open skies policy, any Canadian or U.S. airline found fit to do so by its respective aeronautical authority could offer service on any transborder route at any time. This policy would mean the virtual deregulation of the transborder market, thus allowing for a market-driven regime.

The third scenario is open skies with cabotage. Cabotage, sometimes known as the seventh freedom of the air, is the freedom for an airline to carry domestic traffic within a foreign country. For example, a "right-of-cabotage" would exist if an Air Canada plane flying to Chicago and then on to Los Angeles had the privilege of picking up passengers in Chicago and carrying them to Los Angeles. This would mean unrestricted, integrated competition for carriers of both countries, in both countries.

Since the negotiations began, one of Canada's major priorities has been to obtain a phase-in period whereby our airlines could operate on certain routes between major Canadian centres and American points for several years before any U.S. carrier could serve the same routes. The Canadians want a longer transition period than is favoured by the Americans.

Another Canadian priority is to obtain guaranteed access (including favourable slots and gates) to major U.S. hubs such as New York and Chicago, which are at present controlled by American carriers. Because almost all U.S. airports are operated by local authorities, the American government is arguing that it cannot impose guaranteed access. Finally, the Canadians would like to have a dispute settlement mechanism, similar to the panel used in Free Trade Agreement disputes, to resolve air transport disputes between the two countries. At present, these negotiations are on hold until the Clinton Administration in Washington appoints a new U.S. negotiator.

As noted earlier, during the fall of 1990 a Special House of Commons Committee studied proposals for a Canada-United States Air Transport Agreement with the aim of providing broad objectives and guiding principles to the government in developing its negotiating strategy. The Committee held public hearings across Canada and travelled to Washington, D.C., in order to canvass the views of communities, provinces, the aviation industry, labour groups, the business community, the tourism industry, and the shipping and travelling public. In its report of January 1991, the Committee called for a new transborder air agreement that, among other things, would have a phase-in period, ensure the continued viability of our airline industry, guarantee competitive access for Canadian carriers to U.S. airports, and maintain our high safety standards.

Since these negotiations began two years ago, much has happened in the North American airline industry. In the United States, carriers have gone bankrupt, the surviving carriers' debts have risen, and services have been consolidated. In Canada, our two national carriers have faced huge debt loads and decreasing revenues. Both Canadian Airlines International and Air Canada have now entered into agreements with U.S. carriers with regard to equity participation and strategic alliances.

When the Standing Senate Committee on Transport and Communications began its study of open skies in June 1993, it heard testimony from Canada's Chief Air Negotiator, Daniel Molgat, on the transitional approach to open skies; equal airport access for both countries; creation of a dispute resolution system similar to that in the Free Trade Agreement; and enhanced customs and immigration pre-clearance procedures at Canadian airports.

The negotiations begun in April 1991 had at least 12 rounds before being suspended in December 1992, primarily because of the election of a new President and hence, a new Administration. No formal negotiations took place in 1993, mainly because the new Administration was slow to appoint a new chief air negotiator and develop a negotiating strategy. A high level Presidential Commission made a quick study of the state of the U.S. airline industry and submitted recommendations to the President in August 1993. These recommendations acknowledged that a multi-lateral, rather than a bilateral approach, might well be the option for future air agreements.

Pressure has been building in some quarters (mainly from interest groups and business and tourist organizations) for a reopening of negotiations; earlier this year the U.S. Secretary of Transportation, Federico Pena, announced the same goal. Canadian airlines are approaching such suggestions with a great deal of caution; unless our carriers have the necessary safeguards in place, they are not anxious to enter into a new era of open skies. The House of Commons Standing Committee on Transport, as part of a Tripartite Air Study (TAS), plans to examine the status of bilateral air negotiations between Canada and the United States.

RAIL

A. Proposed Merger of CN and CP Rail in Eastern Canada

Some months ago, CN and CP announced that they were developing a plan to merge their freight networks east of the Manitoba border. Senior officials in both companies have stated that the railways face a grave crisis and that without dramatic action Canada will no longer have a viable, competitive, Canadian-owned national railway system. With respect to their eastern operations, the two railways have sustained losses of \$2 billion over the past five years, as a result of competition from trucks and U.S. railways combined with the recession. Most of the country's manufactured goods, products best suited to shipping by truck, are made in eastern Canada, while its natural resources such as wheat, coal and potash, best shipped in large volume by rail, are found in the west. The two railways met with the Minister to outline their merger proposal for rail rationalization in eastern Canada. The Minister instructed them to bring a detailed plan back to him for consideration.

After more than six months of talks, negotiations broke down in July 1994, mainly because the two railroads were far apart in their valuation of each other's assets. While refusing to divulge actual valuations, CN believed that its larger eastern operations were worth \$650 million more than those of CP. CP Rail now proposed to purchase CN's operations east of Thunder Bay.

On 22 September 1994, CP Rail System (CPRS) made CN North America and the government of Canada a \$1.4 billion offer, financed by Canadian Pacific through existing resources, to enter into an agreement in principle to purchase CN's railway operations east of Winnipeg and Chicago. Under the proposal, CN would continue to have its own rail link between Winnipeg and Thunder Bay and would be able to compete for eastern rail traffic through a special access agreement.

CPRS's proposal includes acquisition of not only fixed plant and facilities but also an appropriate portion of CN's locomotive, freight car and intermodal container fleet. The offer does not include non-rail businesses such as CN real estate or the CN Tower in Toronto. CPRS said its offer would be open for 90 days, with the purchase proposal subject to governmental approval and to a satisfactory "due diligence" review of the business. It calls for the government to consider an expedited process to obtain the required Canadian reviews and to permit the transfer of assets, the construction of rail connections and the eventual abandonment of surplus assets, as well as to determine appropriate bargaining units for labour contracts. The offer contemplates negotiating final agreements, which would be subject to the approval of the boards of directors of CP and CN, with 1 January 1996 as the effective date of the purchase.

Under the proposal, CPRS would offer employment to all CN employees directly involved in the business at the time of closing. Unionized employees would be integrated under the terms of the Canada Labour Code and in accordance with established contractual obligations. Seniority lists would be dovetailed and new collective agreements reflecting different work rules on CPRS would be negotiated. Transferred CN employees would come to CPRS with the same salary, benefit levels, and pension arrangements.

The number of jobs would be reduced gradually over a three- to four-year period, with CPRS being responsible for severance costs. By the year 2000, the total workforce in the east could drop to approximately 16,500 people, a reduction of 2,500 from the level expected

by the end of 1995. CPRS would assume the obligation to make employment security payments to CN workers laid off from the eastern business prior to the acquisition.

CPRS's purchase offer includes a special renewable 20-year eastern access agreement with CN. It is designed to give shippers in the east continued access to competitive rail alternatives for freight business moving between eastern and western Canada. The agreement, the details of which are subject to negotiation, is similar to haulage arrangements used widely in the United States but is unprecedented in its scope and the market access it would provide.

Specifically, the access agreement would apply to all CN traffic moving between western Canada and areas within a 30-kilometre radius of Toronto and Montreal. CN would still continue to be able to compete with CPRS for western Canada traffic from the auto manufacturers in Oshawa and Oakville and to interline its traffic with that of CPRS and other railways at Toronto and Montreal.

Under the agreement, CPRS would provide CN with all services normally associated with handling traffic, including line-haul transportation, switching at customer sidings, movement of empty rail cars and interchange services. CN would be responsible for providing rail cars and would be free to market and price its own services. This would give shippers and receivers in eastern Canada competitive access to both railways.

The fees charged by CPRS would be negotiated with CN on the basis of the current average cost of handling the traffic. The two railways would establish binding service criteria for the various types of traffic. The agreement would also permit CN to provide special services to its customers, including dedicated single-commodity trains and multi-modal services.

The terms of the proposed access agreement, including rate levels, would be subject to readjustment every five years. If the merged operations and increased traffic volumes lowered overall costs, the haulage rates could be reduced accordingly. Any disputes would be resolved through arbitration.

Some, including the Minister of Transport, have asked whether the railways should also be considering this option for their operations west of Winnipeg. Obviously, the operation of a single railway in eastern Canada would affect the entire system of both railways, with respect to scheduling, freight routings, and freight rate structure. Would there be sufficient

traffic for two railroads to continue to operate profitably in the west? For example, if we continued to see an increase in the amount of grain moving into the U.S., would it be carried by rail or truck? With shorter distances involved, trucking might become a more attractive option. Also, if the *Western Grain Transportation Act* is changed so that the subsidy is paid to the producer, rather than directly to the railways as is now the case, producers might be in a better position to negotiate cheaper rates with truckers on the short haul routes (see below).

Moreover, as a result of NAFTA, more products may move in a north-south direction for short hauls to U.S. destinations close to the border. All these factors could mean less traffic for the railways in the years ahead. Also to be considered is the impact of directional shifts of traffic and loss of traffic (especially of grain) on the Port of Vancouver. More freight traffic moving in a north-south direction could result in less grain and fewer raw materials from the west passing through the port. Also, if more grain is trucked south, less grain will be shipped by rail to Vancouver. These diversions could have a serious impact on the future of the Port of Vancouver and should be looked at carefully when decisions are being made on the merging of railways in western Canada and changes to the *Western Grain Transportation Act*.

B. Western Grain Transportation Act (WGTA)

The movement of grain by rail to export positions is likely the most regulated transportation in Canada. Since 1897, when the *Crow's Nest Pass Act* was passed, the government has regulated and controlled grain freight rates. By the 1970s, there was a substantial gap between these statutory rates and the actual costs of shipping grain. The railways were sustaining huge losses and the situation was critical.

The government's response was to enact the WGTA in 1983. This provided for the continued regulation of freight rates and an annual subsidy to the railroads based on the difference between what the producer paid to ship his grain in 1982 and the actual cost of shipping grain in that year. The subsidy, currently \$720 million, is called the "Crow Benefit." For the crop year 1992-93 the total freight rate is \$32.12 per tonne, of which the producer's share is \$11.98 and the government's \$20.14. The WGTA rate-setting formula envisages that, as the cost of moving grain rises and the volumes increase, the government's share will remain unchanged, except for an inflation adjustment. As a result, the producer will pay an increasing proportion of the annual freight rate for shipping grain.

One issue is whether the subsidy should continue; in these times of fiscal restraint, it is asked whether the government can afford to pay it. overshadowing that concern is the question of whether such an "export" subsidy would be permissible under new GATT arrangements. It is suggested that paying the "Crow Benefit" to the producer, rather than the railways, would increase the efficiency of the entire grain handling and transportation system, significantly expand western livestock production, aid western Canadian diversification efforts, without seriously reducing total grain output.

C. The Future of VIA Rail

Since January 1990, when 50% of its network was cut, VIA Rail has significantly reduced its subsidy while improving services both in the Quebec City-Windsor corridor and on the transcontinental route. It appears, however, that subsidy reduction cannot continue without a major cut in services. Conversely, an expansion of VIA services would require a higher subsidy. Currently, the government is considering whether it should reduce the very high subsidization of VIA's remote services. There is no possibility that VIA will make enough money to pay itself for the costly new equipment and locomotives needed before the end of the decade; is the government prepared to pay for these?

Large reductions to subsidies during the past year have led VIA to examine the future of some of its services. In 1995-96, the federal subsidy to VIA will be reduced from \$331 million to \$281 million and to \$233 million in the following years. In response to this, according to recent reports in the press, VIA is planning to eliminate up to eight of its passenger routes countrywide. The following routes have been mentioned: Montreal-Saint John-Halifax; Jasper-Prince Rupert; Toronto-Sarnia; Toronto-Niagara Falls; Sudbury-White River; Montreal-Gaspé; Montreal-Jonquière; and Winnipeg-The Pas.

D. High Speed Rail Passenger Services

1. Quebec City-Windsor Corridor

Over the past few years, there has been considerable debate on introducing high speed rail passenger services (HSR) in the Quebec City-Windsor corridor. The European experience demonstrates that there are really only two HSR technologies. One is designed for

upgraded, existing electrified track (the Swedish X-2000 train) and the other for new, dedicated electrified right-of-way track (the French TGV). While the infrastructure costs for the X-2000 are less expensive than for the TGV, both options would require substantial capital funds.

Canadian studies have demonstrated beyond doubt that HSR in the corridor is technologically feasible; however, as in Europe and Japan, government funding would be required for the construction of infrastructure. The Standing Committee on Transport, in its study on HSR, recognized that the government would have to be involved in any high speed rail project, there would not be a sufficient return for the private sector to undertake it alone. The Committee recommended that the federal government should not immediately make a financial commitment to the development of HSR in the Quebec City-Windsor corridor. It must first be clearly demonstrated that the public would reap substantial socio-economic benefits from such a project (such as reduction of air pollution from automobiles and airplanes, improved energy consumption, less airport and highway congestion and deferral of significant public investment in highway and airport infrastructure). Even so, the Committee concluded that such a project would require a "leap of faith." It recognized, however, that the government might want to proceed with high speed rail for other reasons, such as the need to stimulate the economy. Here again, it should be noted that the recent Report of the Royal Commission on National Passenger Transportation recommended that "governments invest in high speed rail infrastructure only if the benefits to the passenger transportation system exceed the costs, and if taxpayers do not have to pay any operating subsidies."

A \$6-million federal-provincial private sector high speed rail study has also been launched but no report is expected until at least late 1994. At that time, the federal government will have to decide whether to make a financial commitment to "kick start" the project. Meanwhile, over the next few months, the X-2000 will be in revenue service for AMTRAK in the U.S. northeast corridor (Boston-New York-Washington). This demonstration project could affect the debate on HSR in Canada.

2. Vancouver-Seattle High Speed Rail Link

The possibility of a high speed rail service between Vancouver and Seattle is also being considered. After a 13-year interruption, passenger service between Vancouver and the

United States is set to resume on 1 October 1994, a first step towards an \$800-million U.S. high speed service in the 750-kilometre corridor stretching south to Eugene, Oregon. The U.S. government insisted on minimum speeds and through service over the full length of the corridor to Vancouver before granting funds.

Initially, AMTRAK, the operator of the service, will use conventional bi-level rolling stock capable of speeds of 125 kilometres an hour with a resulting travel time of 3 hours and 55 minutes between Vancouver and Seattle. The goal is to have a high speed train operating by 1997 that will achieve speeds of 200 kilometres per hour and reduce the travel time to 2 hours and 45 minutes. The estimated round trip fare is expected to be between \$30 and \$50 U.S.

To promote the service, the high speed Spanish Pendular Talgo train, a lightweight eight-car train carrying 200 passengers (two-thirds the capacity of a Boeing 747), has been leased to the Washington State Transportation Department for six months. Normally propelled by electricity from power cars that run in front of and behind the coaches, the train will use a diesel locomotive on the test run. The "Talgo" uses new tilt technology whereby each axle supports vertical air cylinders from which opposing car ends are suspended. This allows the car bodies to respond to centrifugal forces, swinging outward on curves and then returning to the upright position on straight stretches of track. For railways with older track this boosts speed by 20% to 40%, without causing passenger discomfort.

Achieving the long-term goal of 200 kilometres per hour on the run between Vancouver and Eugene would require an estimated \$1.8 billion for track upgrading and new signalling technology. This amount is expected to be allocated as follows: \$800 million from the State of Washington; \$450 million from Oregon; and \$50 million from British Columbia. Initially, Burlington Northern, a partner in the venture, will pick up the estimated costs of between \$1 million to \$3 million U.S. for upgrading track in B.C. Further negotiations between B.C. and the State of Washington will determine the province's ultimate contribution.

HIGHWAYS: NATIONAL INFRASTRUCTURE PROGRAM

In 1991, the Council of Transportation Ministers (federal and provincial) launched a comprehensive highway policy study to identify a national highway system, define the

minimum design and service standards desirable, and provide costing options for a four-lane route across Canada. The range of cost estimates runs from approximately \$12 billion to at least \$18 to \$20 billion. The study also looked at the institutional and funding mechanisms used to build roads in Canada and those used elsewhere in the world. The major question is who should pay: the general taxpayer, or the users through a direct tax and/or tolls. Another possibility is the privatization of road construction and operation, as is being implemented for certain motorway routes in England.

There is a growing consensus that the rebuilding of Canada's national highway infrastructure is essential if this country is to compete, not only in North America but in the global economy. Clearly, both levels of government will have to be involved in paying for the program and the funding mix must be clarified. The federal government and the provinces may well make a decision on a highway infrastructure program soon.

MARINE ISSUES

A. The Canadian Coast Guard (CCG)

1. General

The Canadian Coast Guard is responsible for promoting safe, efficient and economical marine transportation and navigation. Its main functions are the operation and maintenance of marine navigation systems, ice breaking and Arctic operations, a marine regulatory regime, search and rescue and 526 public harbours and ports. According to the Estimates for 1992/93, there are approximately 6,000 Coast Guard employees with a budget of \$650 million and a vessel complement of 80 large vessels, 354 inshore work and rescue boats, 35 helicopters, 3 hovercraft and one fixed wing aircraft. Cost recovery levels for these services are very low.

The challenge for the CCG has been to control its costs and carry out its activities more efficiently with fewer resources. A major part of its operating budget and capital expenditures is devoted to its fleet. The CCG is implementing a three-year major fleet restructuring plan to reduce crew sizes, decommission ships and redeploy the remaining fleet so as to maximize efficiency and effectiveness.

2. Lightstation Destaffing

One Coast Guard issue of concern to the west coast is lightstation destaffing, which began as part of a cost reduction program the late 1970s and early 1980s. At first, destaffing was accomplished through attrition and retirement; however, by the mid-1980s, the Department of Transport began to implement a policy of active destaffing coinciding with the automation of lightstations across Canada.

Between 1970 and 1985, all 264 lightstations were automated, in some cases with remote monitoring equipment, at a capital cost of \$15 million; 57 lightstations were destaffed on an "opportunity" basis, for example on the retirement of the lightkeepers.

Between 1985 and 1993, the Canadian Coast Guard carried out a major project to install remote monitoring equipment and destaff 137 more lightstations at a capital cost of \$17 million. Many indeterminate lightkeepers retired, but those wishing to continue their careers were placed in other jobs.

When, in March 1992, the Minister of Transport directed the Coast Guard to defer further activity on lightstation destaffing, Sand Heads lightstation in British Columbia had already been destaffed for safety reasons. In January 1994, the Minister approved the permanent destaffing of this lightstation.

Of the 70 staffed lightstations now in Canada, 35 are on the west coast, 32 in Newfoundland, and three in the Maritimes. Records for the 137 lightstations destaffed since 1985 show a current annual Operating & Maintenance saving of \$7 million, with a cumulative saving since 1985 of \$32.6 million.

In the U.S., between 1968 and 1986 a total of 202 lightstations were destaffed; to date, the U.S. has destaffed all but one of 475 lightstations. New Zealand has destaffed all of its 42 lightstations. Destaffing should be completed in Australia by 1995 and in the U.K. by 1997.

In Canada, the Coast Guard has initiated a full strategic review and restructuring of all operational programs, including destaffing. The Coast Guard's mission is to contribute to a safe, environmentally sound marine transportation system. A number of issues have been raised by the public (e.g., users of the service such as recreational boaters and commercial

shipping). Their main concern is a possible decline in the safety-related services at destaffed lightstations, rather than the reliability of automated aids to navigation. They ask who, in the absence of lightkeepers, will spot mariners in distress for Search and Rescue (SAR) teams, give boaters up-to-the-moment information on marine weather and local sea conditions, and report aviation weather at local lightstations. These are all important issues for the Coast Guard to address in its review of its operational program for lightstation destaffing.

B. The *Jones Act*

Under the *Jones Act*, all goods carried by water between U.S. ports must be transported by American-owned, American-built and American-crewed ships. Canada's shipowners, convinced that they could compete in an open North American market, unsuccessfully tried to put the *Jones Act* on the table at the time of the Free Trade negotiations; another effort, made during the North American Free Trade negotiations, was no more successful. Our shipowners continue to press the case for "open waters" negotiations.

The *Jones Act* has, however, provided one major benefit for the Port of Vancouver. To reserve domestic trade for American ships, the Act prevents foreign ships from making two consecutive stops at U.S ports. For example, if a foreign cruise makes a stop in Seattle it cannot go on to make a second stop in Alaska. Thus, foreign cruise ships choose to follow the scenic voyage to Alaska after stopping in Vancouver, which as a result has a virtual monopoly on Alaska cruises. There is, however, mounting pressure from Seattle and the State of Washington to have the *Jones Act* amended to allow foreign ships to make more than one stop at U.S. ports. Fewer ships might then stop at Vancouver, with serious economic consequences for the port.









